

COMMONWEALTH OF KENTUCKY

BEFORE THE PUBLIC SERVICE COMMISSION

In the Matter of:

INVESTIGATION OF THE OPERATING CAPACITY)	
OF MARTIN COUNTY WATER DISTRICT)	CASE NO. 2002-00116
PURSUANT TO KRS 278.280)	

WRITTEN TESTIMONY OF BEVERLY DAVIS

ON BEHALF OF COMMISSION STAFF

1 **Q1 State your name and business address.**

2 Beverly Davis, Public Service Commission, Post Office Box 615, Frankfort, Kentucky
3 40602.

4 **Q2 Who is your employer?**

5 A Public Service Commission of Kentucky ("PSCKY").

6 **Q3 How long has the PSCKY employed you?**

7 A I have been an employee of the PSCKY since December 1987.

8 **Q4 What is your current position?**

9 A Manager, Financial Audits Branch.

10 **Q5 How long have you held that position?**

11 A Since February 1995.

12 **Q5 As manager of the PSCKY's Financial Audit Branch, what are your duties?**

13 A I manage a staff of two professional employees who perform financial examinations
14 of regulated utilities. I research and make recommendations to the Commission on
15 accounting issues. I provide technical assistance to utilities regarding accounting and
16 the uniform system of accounts.

17 **Q6 Prior to your appointment as manager of the PSCKY's Financial Audit Branch,**
18 **what position did you hold with the PSCKY?**

19 A I held various positions within the Financial Audit Branch. In these positions, I
20 examined the records and accounting systems of public utilities under the jurisdiction of
21 the PSCKY. Applying professional auditing standards, methods, and procedures, I would
22 evaluate the accuracy of financial information of public utilities under the jurisdiction of

1 the Commission. I also provided technical assistance and training to less experienced
2 auditors and reviewed their work product.

3 **Q7 Briefly describe your educational background.**

4 A I received a Bachelor of Science Degree in Administrative Services from Western
5 Kentucky University in 1975. From 1981 to 1983, I attended and completed 24 hours
6 of accounting courses at the University of Louisville.

7 **Q8 Are you licensed to practice as a certified public accountant?**

8 A Yes. Since 1990 I have been licensed by the Kentucky State Board of Accountancy
9 to practice as a certified public accountant.

10 **Q9 To what professional societies do you belong?**

11 A I am a member of the Kentucky Society of Certified Public Accountants.

12 **Q10 As a part of PSC Case No. 2002-00116, did you conduct an examination of the**
13 **records and accounting practices of Martin County Water District ("MCWD")?**

14 A Yes. By Order dated July 1, 2001 in PSC Case No. 2002-00116, the PSCKY
15 directed its staff to examine MCWD's "books, records, and documents and to identify
16 any problems or irregularities that may affect or may have affected Martin District's
17 ability to perform its obligations under KRS Chapter 74 and Chapter 278." It further
18 directed Commission Staff to interview all appropriate persons involved in the water
19 district's past and present operations."

20 Between July 23 and July 25, 2002, Christina Whelan, James Rice, and I visited
21 MCWD's office to examine the water district's records and facilities. Ms. Whelan is
22 an audit reviewer in the Financial Audits Branch and is also a certified public
23 accountant. Mr. Rice is assigned to the Commission's Engineering Division. Ms.

1 Whelan and I focused our examination on MCWD's accounting records. During the
2 course of our inspection, we spoke with Maurice Mills, MCWD's Office Manager, and
3 MCWD's office employees Melanie Fletcher and Kathy Runyon.

4 After our initial visit, Ms. Whelan and I returned to MCWD's office on
5 August 6 and 7, 2002 to review additional records. Following our visits, I also had
6 several telephone conversations with Mr. Mills and Ms. Fletcher regarding some of
7 MCWD's accounting records and business practices. I also spoke briefly by telephone
8 with John Tackett, MCWD's CPA.

9 **Q11 What records did you and Ms. Whelan examine?**

10 **A** We examined selected accounting records, including certain billing records, receipt
11 records, deposit tickets, bank statements, cancelled checks, invoices, and work orders.

12 **Q12 What billing records did you review?**

13 **A** We examined MCWD's billing records for 2001 and 2002 to the date of the field
14 review. We examined current service and usage amounts for each month. We also
15 reviewed two types of reports: a bill recap which includes detailed customer
16 information and a close-out report. The bill recap is run immediately after bills have
17 been printed. The close-out report is run after adjustments have been made, after late
18 payment penalties have been applied, and just before meter reading information is
19 entered for a new billing cycle. The current service per close-out report includes late
20 payment penalties but current service on the bill recap does not include penalties.

1 **Q13 What did your review of MCWD's billing records reveal?**

2 A Not all billing records requested were available for review. Bill recaps were not
3 available for December 2001 or January 2002 for either division.¹ The close-out report
4 for March 2001 for Division B said meters were not read and had no balances for
5 current service or usage for that month. Meter readings were not available for Division
6 A for May.

7 Some adjustments had been made to customer bills even though there was no
8 evidence the customers had not used the water. Office personnel reported that it was
9 discovered that one of the contractor meter readers was estimating usage rather than
10 actually reading meters. MCWD began adjusting bills of customers that complained
11 about receiving a large "catch-up" bill after meters were actually read. Commission
12 Staff advised MCWD by letter that such adjustments violated KRS 278.160 if the
13 customer had actually received the water billed.

14 Accurate information regarding the gallons of water sold was not available for
15 January, April, May, or June 2002. The billing records for at least one division
16 reported a negative usage for those months. Additionally, the usage records for July
17 were so large as to be obviously inaccurate. Without accurate information regarding
18 the amount of water sold, it is impossible to calculate a meaningful water loss
19 percentage. Commission Staff advised district personnel to review the billing records
20 each month and if a negative or abnormally large or small usage was reported to try to

¹ MCWD operates as two divisions. In 1996 Martin County Water District No. 1 and Martin County Water District No. 2 merged. While MCWD is now a single water district, it has divided its operations into two divisions that reflect the same geographical boundaries of the MCWD1 and MCWD2 and maintains separate records for each division. Division A encompasses the boundaries of MCWD2 and Division B encompasses the boundaries of MCWD1.

1 determine the cause and revise the billing as appropriate to obtain meaningful usage
2 information.

3 MCWD reads its meters only to the thousand digit. Therefore, if a customer
4 uses only a few hundred gallons of water for the month the usage can show up as zero.
5 MCWD's usage information would be more accurate if billing was computed based on
6 hundred gallons rather than thousand gallons. Commission Staff recommend MCWD's
7 meter readers record the entire meter reading to provide more complete information
8 and to help identify defective meters.

9 MCWD was applying a five-percent late payment penalty to delinquent bills of
10 one division. Its filed tariff provides for a ten-percent penalty. MCWD personnel
11 entered the correct rate into the billing program during the field visit. MCWD's filed
12 tariff states that the penalty will be applied to the delinquent amount of the bill less
13 taxes. However based on the records reviewed, the billing program is computing the
14 penalty on service and taxes. While there is no regulatory or statutory prohibition
15 against computing the penalty on taxes, the District must follow its filed tariff and
16 should discontinue computing late payment penalty on taxes.

17 The billing recap for July 2002 was reviewed and it was noted that a significant
18 number of what appeared to be non-residential accounts were not being charged sales
19 tax. A list of the questioned accounts was provided to MCWD personnel and
20 Commission Staff recommended that the customer accounts be reviewed to ensure that
21 sales tax is collected from all non-residential customers that do not provide a tax
22 exemption certificate.

1 At the time of the inspection, MCWD was not billing sewer customers of the
2 Lovely, Kentucky, Pride Demonstration Project. In an Order dated October 21, 1999,
3 the PSCKY authorized MCWD to charge the six homes in the demonstration project a
4 monthly sewer rate of \$26.25. At the time of the field visit, MCWD office personnel
5 said they were not aware the District operated a sewer facility. Mr. Rice discovered a
6 file containing information, including old billing information, regarding the Lovely
7 Demonstration Project in the treatment plant. We provided this file to the office staff
8 and recommended that the information be reviewed and the sewer customers be billed
9 as appropriate.

10 Assuming the past due information provided by MCWD's billing program is
11 accurate, MCWD's accounts receivable balances have increased significantly during
12 2002. The following information regarding past due balances was obtained from the
13 billing records:

14 February	\$ 23,987.19
15 March	26,157.80
16 April	31,223.70
17 May	42,191.09
18 June	59,980.48
19 July	81,011.95

20 MCWD office personnel reported that no disconnect notices had been issued
21 during the time they had been working at the office. At the time of the second field
22 visit, MCWD personnel were working on disconnect notices to send to past due
23 accounts.

1 **Q14 What did your review of MCWD's records of receipts reveal?**

2 **A** MCWD's records of receipts, including deposit tickets and receipt books, were
3 reviewed. It was noted that MCWD charges a service connection fee of \$15, a tap-on
4 fee of \$350, and a customer deposit of \$45. All of these charges are included in its
5 tariff.

6 Based on the records reviewed, there is some question regarding whether MCWD
7 has charged the service connection fee in all cases or, in the alternative, whether
8 appropriate records of collection of the service connection fee have been maintained. A
9 sample of 18 work orders for service connections was selected with dates from January
10 7, 2002 through July 19, 2002. These were then traced to the receipt books to
11 determine whether a \$15 service connection fee was collected in accordance with the
12 tariff. Only six of the work orders could be traced to the receipt books.

13 Although MCWD received a number of checks that were returned for insufficient
14 funds from its customers, there was no evidence that it charged a returned check fee as
15 provided for in its tariff. One of the office staff reported charging the fee on two
16 occasions. There was also no evidence that MCWD charged any of the other non-
17 recurring charges included in its tariff other than the reconnect, the tap-on, customer
18 deposit, and the late-payment penalty. The District should review the non-recurring
19 fees included in its tariff and charge all fees, as appropriate, in a uniform and consistent
20 manner.

21 **Q15 What observations, if any, do you have regarding MCWD's cash disbursement**
22 **procedures?**

1 A MCWD has fourteen bank accounts. I reviewed bank statements with cancelled
2 checks and deposit tickets for all accounts for 2001 and 2002 to the date of the field
3 review. All bank statements for 2002 to date were available. All statements except
4 four were available for review for 2001. The 2000 bank statements were available but
5 had been separated from the cancelled checks and deposit tickets, which were not with
6 the other records.

7 MCWD was not maintaining a check register, or other cash disbursement journal,
8 with an ongoing cash balance. The office clerk said she had not been instructed on
9 keeping any type of record to determine how much money remained in any bank
10 account or whether sufficient money was available to cover checks written. The
11 operating account was overdrawn in June 2002 and some June 2002 checks from the
12 payroll account were returned for insufficient funds. I could not determine what type
13 of record the previous office manager maintained. Since none of the fourteen accounts
14 had been overdrawn in 2001, I presume that some type of cash disbursements journal
15 was used. Since the current office manager began work in July, MCWD has been
16 contacting the bank to determine the current balance in the bank accounts before issuing
17 any checks. The office manager is in the process of entering MCWD's financial
18 information into a general ledger bookkeeping system and will use that to maintain
19 current information on cash balances.

20 In the 2001 financial information that MCWD provided, there were no monthly
21 bank reconciliations other than those performed by MCWD's CPA after year-end.
22 There were also no reconciliations done during 2002. It is very important that bank
23 reconciliations be performed on a timely basis each month. To maintain good internal

1 control, I recommend that that the bank statements be received and the reconciliations
2 be prepared by an individual without direct responsibilities for handling or accounting
3 for cash.

4 I found no documentation that MCWD is following appropriate approval procedures
5 for disbursement of funds. KRS 74.050 provides that "[t]he treasurer of the
6 commission shall pay out the funds of the commission only upon presentation of
7 warrants signed by the chairman and countersigned by the secretary of the
8 commission." The minutes of Board of Commissioners' meetings provided by MCWD
9 indicated that invoices were reviewed and approved for payment but there is no
10 documentation of this procedure. MCWD should document its review of all proposed
11 disbursements by its chairman and the secretary by initialing or signing invoices and
12 disbursement requests approved for payment or by signing a list of proposed
13 disbursements that includes the vendor and amount of each proposed disbursement. If
14 the MCWD elects to sign a list of proposed disbursements, the list should be
15 maintained with the minutes of the Commissioners' meetings to document the specific
16 payments approved. Additionally, the treasurer should sign all checks since KRS
17 74.050 specifies that the treasurer is responsible for paying out the funds of the
18 District.

19 I also found that invoices were not being cancelled after payment to ensure that an
20 invoice was not inadvertently paid twice. In reviewing the information filed by MCWD
21 as Exhibit 5 in response to Commission Staff Interrogatories, it was noted that a few
22 invoices had been paid twice resulting in overpayments on some accounts with
23 American Electric Power Company. Marking invoices as paid lessens the possibility of

1 this occurring and will also provide a better audit trail. At the last field visit, I noted
2 that MCWD had begun to stamp invoices as paid with the date and the office manager's
3 initials.

4 I also found that receiving reports or similar documentation were not attached to
5 invoices for materials and supplies verifying that the items had actually been received in
6 good condition. The operation or office staff person that receives a shipment should
7 examine the items received and make appropriate notations on the shipping report or
8 receiving report showing that items were received and in good condition. The shipping
9 or receiving report should then be matched to the invoice so the District can be sure
10 that it has actually received an item before payment is made.

11 My review of invoices also showed that some vendors and service providers are
12 charging MCWD sales tax. MCWD is exempted from the payment of sales tax. Some
13 service providers with whom the district has multiple accounts were charging sales tax
14 on some accounts but not on others. I recommend that MCWD carefully review all
15 invoices and when sales tax is being charged provide a copy of its exemption certificate
16 to the vendor or service provider with a request that sales tax charges be discontinued.

17 Based on the records reviewed during the field examination, discussions with office
18 personnel, and a review of documents submitted in response to Commission Staff's
19 First Set of Interrogatories, it appears that MCWD has not paid all its obligations in a
20 timely fashion during 2002. It appears that due to a turnover in office personnel there
21 was a breakdown in the normal procedures for processing disbursements. It appears
22 MCWD's Commissioners did not provide the necessary oversight to ensure that basic
23 operations for processing disbursements continued in a timely manner. However, the

Commissioners have hired an office manager who began work on July 15, 2002. He has contacted MCWD's vendors and service providers to determine the amounts owed, matched this information with invoices, and compiled a list of accounts payable. MCWD is working on becoming current on its obligations.

Q16 Did you conduct any review of MCWD's customer service processes?

A Receipt records and work orders were reviewed and discussions were held with MCWD office personnel to evaluate selected customer service processes. A sample of 25 customers that paid a tap-on fee was selected from the receipt books for review. The tap-on fees were all paid during a period from January 4, 2002 to July 11, 2002. The tap-on and work order records were reviewed on August 7, 2002.

It does not appear customers are being connected to MCWD's system in accordance with 807 KAR 5:006, Section 13(4), which requires installation and connection of new service within 72 hours after the customer complies with all requirements. For the sample selected, only 16 work orders could be located. Of those, only four had completion dates specified. None of those met the 72-hour requirement. Of the 16 work orders located, ten are still in open status indicating that the work has not been completed. However, one work order noted that the tap would not be needed until August. Four of the applicants for whom no work order could be located are connected to the system, receiving service, and being billed according to office staff and another is for a house that is still under construction.

Based upon the review of MCWD's records, it does not appear MCWD's procedures have been followed consistently. Either work orders have not been completed in all cases when a tap-on fee is paid or the work orders are not always filed

1 in the proper place. There was one work order where the work was apparently
2 completed but no completion date was entered. Although it was difficult to trace
3 through the system, it appears there was sometimes a delay between the time a meter
4 was set and water turned on and the time an account was set up in the billing system
5 and the customer received a bill. Office staff admitted this had been a problem. The
6 District should institute internal controls to be sure work orders are completed in all
7 cases and that all information is recorded on the form. The District should consider
8 adding a line to the work order form to be completed when the account is setup in the
9 billing system to serve as a reminder to complete this step.

10 It also appears that MCWD may not have been following its tariffed policy
11 regarding water line extensions. MCWD's tariff provides that MCWD extend an
12 existing distribution main up to 50 feet at no cost. Applicants are required to deposit
13 the portion of the cost of any water main extension that exceeds fifty feet. According
14 to MCWD's office personnel, MCWD's policy is to extend a water main up to 150 feet
15 at no charge and to require an applicant to pay \$1 per foot for any portion of a water
16 main extension that exceeds 150 feet in length. MCWD's tariff permits MCWD to
17 make extensions under different arrangements from its tariffed policy with the prior
18 approval of the Public Service Commission.

19 MCWD has not paid interest on customer deposits in accordance with the 807 KAR
20 5:006, Section 7(6). In 2000, Commission Staff assisted MCWD in calculating accrued
21 interest on customers' deposits through December 31, 2000. In January 2001, the
22 District provided a billing register showing credits to customers' accounts for the
23 accrued interest. At that time, Commission Staff explained the requirement to pay

1 interest annually on an ongoing basis. In reviewing the billing records during the field
2 review, no evidence was found that interest on customer deposits was paid for the year
3 2001. Additionally, office staff reported that interest had not been paid on the few
4 deposits that had been refunded during the last few months. During the field visit,
5 Commission Staff advised MCWD to pay interest when refunding deposits and
6 explained the need to pay interest annually for those deposits that are not refunded. We
7 also provided a list of customer deposits held as of December 31, 2000 and explained
8 the need to update the list so the District has current information on the deposits it is
9 holding.

10 **Q17 Did you note any other conditions during your review?**

11 **A** Yes. In the course of performing our review, Commission Staff contacted the
12 Department for Local Government ("DLG") to obtain a copy of MCWD's operating
13 budget. DLG checked the budget files from 1999 through 2002 and advised that
14 MCWD has not submitted a budget for any of the years reviewed. DLG reported that
15 the county attorney had been notified but presumed that he decided not to pursue the
16 matter. KRS 65.065 requires preparation of an annual budget by the governing body of
17 a special district. The statute further states that no moneys shall be expended from any
18 funds or sources except in accordance with the budget filed with the fiscal court. In
19 addition to being a statutory requirement, preparation of an annual operating budget is
20 an important financial planning tool. I recommend that MCWD prepare a budget for
21 its next operating period and file that budget with Martin County Fiscal Court at least
22 thirty days prior to the start of the calendar year.

1 Martin County Water District has not filed an annual report for 2001. The report
2 was due March 31, 2002. MCWD requested and received an extension until April 30,
3 2002 to file the annual report. MCWD requested and received another extension until
4 May 31, 2002. MCWD requested another extension until June 30 to file the annual
5 report but that request was denied. I contacted John Tackett, MCWD's CPA,
6 regarding when the annual report will be completed. Mr. Tackett said his office is
7 waiting for additional information from MCWD before the report can be completed.
8 MCWD should provide the requested information as soon as possible so the report can
9 be completed and filed as quickly as possible.

10 **Q18 Briefly summarize your recommendations for improving MCWD's operations.**

- 11 **A**
- MCWD should consider developing internal controls to help ensure it
12 receives accurate monthly meter readings for customer meters.
 - MCWD's meter readers should record the complete meter reading, not
13 merely record readings at the 1,000 gallon level.
 - MCWD should make billing adjustments made only when sufficient
14 evidence exists that a customer's meter is not accurately registering usage, a meter has
15 been misread, or leak adjustment procedures have been followed.
 - MCWD should discontinue its practice of assessing late payment fees on
16 taxes unless and until it revises its filed rate schedules to permit such assessment.
 - MCWD should review its customer accounts to ensure that sales tax is
17 collected from all non-residential customers who do not provide a tax exemption
18 certificate.
- 19
20
21
22

1 • MCWD should bill all sewer customers for the charges and fees set forth
2 in its filed rate schedule for sewer service.

3 • MCWD should discontinue water service, in accordance with its tariffed
4 rules and PSCKY regulations, to those customers who fail to pay their bills in a timely
5 manner and fail to keep their accounts current.

6 • MCWD should review the charges, fees, rules and regulations that are
7 set forth in its filed rate schedules to ensure that its charges and practices are consistent
8 with its filed rate schedules.

9 • MCWD should maintain a check register or some form of cash
10 disbursement journal for each bank account.

11 • MCWD should reconcile its bank statements with its cash disbursement
12 journal on a monthly basis. Ideally, such reconciliation should be performed by an
13 individual who does not have direct responsibility for handling or accounting for cash.

14 • MCWD should document its Board of Commissioners' review of all
15 disbursements. Its chairman and secretary should initial or sign all approved invoices
16 or disbursement requests or a composite listing of such proposed disbursements.

17 • MCWD's treasurer should sign all issued checks.

18 • MCWD should cancel invoices after payment and should attach receiving
19 reports or similar documentation to invoices on which receipt and condition of items
20 has been documented.

21 • MCWD should review all invoices to ensure that vendors or service
22 providers are not assessing sales tax on its purchases.

1 • MCWD should develop procedures and internal controls to ensure its
2 compliance with Administrative Regulation 807 KAR 5:006, section 13(4) regarding
3 prompt connection of service.

4 • MCWD should comply with the water main arrangements set forth in its
5 filed rate schedule unless the PSCKY authorizes a deviation from those arrangements.

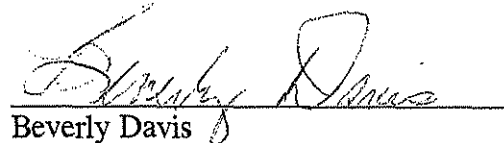
6 • MCWD should pay interest on deposits in accordance with
7 Administrative Regulation 807 KAR 5:006, Section 7(6).

8 • MCWD should submit its operating budget to Martin County Fiscal
9 Court at least 30 days prior to the start of its fiscal year.

10 • MCWD should submit its annual report to the PSCKY as quickly as
11 possible.

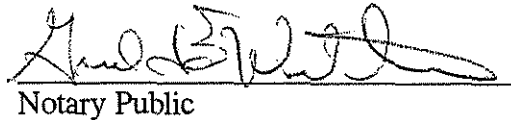
12 **Q19 Does this complete your written testimony?**

13 **A Yes.**


Beverly Davis

COMMONWEALTH OF KENTUCKY)
COUNTY OF FRANKLIN)

Subscribed and sworn before me by Beverly Davis, this 17th day of September , 2002.


Notary Public

My commission expires 24 June 2002.